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In the Supreme Court of the United States

OCTOBER TERM, 1972

No. 71-1665

UNITED STATES OF AMERICA, PETITIONER

v.

DOUGLAS B. CARTWRIGHT, AS EXECUTOR OF THE ESTATE OF ETHEL B. BENNETT

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the district court (Pet. 12-22 [1]) is reported at 323 F. Supp. 769. The opinion of the court of appeals (Pet. 23-33) is reported at 457 F. 2d 567.

JURISDICTION

The judgment of the court of appeals was entered on March 27, 1972. (Pet. 34.) The petition for certiorari was filed on June 22, 1972, and certiorari was

[1] "Pet." references are to the petition for certiorari.

granted on October 10, 1972. (App. 87.[1]) The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether Section 20.2031-8(b) of the Treasury Regulations on Estate Tax, which provides that shares in mutual funds are valued for estate tax purposes at the public offering (asked) price, rather than the redemption (bid) price, is valid.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the Internal Revenue Code of 1954 and of the Treasury Regulations on Estate Tax (1954 Code) are set forth in the Appendix, *infra*, pp. 23–27.

STATEMENT

At the time of her death on December 4, 1964, the decedent, Ethel B. Bennett, owned shares in three open-end investment companies (mutual funds)[2] registered with and subject to the regulations of the Securities and Exchange Commission. Sections 1 through 53 of the Investment Company Act of 1940, c. 686, 54 Stat. 789 (15 U.S.C. 80a–1 through 80a–52). An open-end mutual fund is an organization which continually sells as many of its shares as can be marketed and, as it is required to do by law, con-

[1] "App." references are to the separately bound record appendix.

[2] Decedent owned in her individual name 2568.422 shares of Investors Mutual, Inc., 2269.376 shares of Investors Stock Fund, Inc., and 1869.159 shares of Investors Selective Fund, Inc. She also held in her name as trustee for her daughter 2067.531 shares of Investors Mutual. (Pet. 12.)

tinually offers to redeem its outstanding shares.[4] With the proceeds from the sale of its shares, the fund invests and trades in securities. (App. 24–25, 50.)

The price at which shares in open-end investment companies (mutual funds) are offered to the public (the "asked" price) is the net asset value, which is the fractional value per share of the fund's net assets, plus a sales load or sales charge. The sales load is a varying percentage of the offering price, dependent upon the quantity of shares purchased in a single transaction.[5] The maximum sales load of the funds held by decedent ranged between seven and eight percent and the minimum was one percent. The price at which mutual funds redeem their shares (the "bid" price) is the net asset value. There is no redemption

[4] During their respective fiscal years ending in 1965, Investors Stock Fund, Inc., issued 15,213,211 shares and redeemed 3,936,997 shares; Investors Mutual, Inc., issued 34,499,678 shares and redeemed 9,107,757 shares; and Investors Selective Fund, Inc., issued 1,517,082 shares and redeemed 1,242,746 shares. (Pltf. Ex. 11.)

[5] Shareholders may purchase additional shares with their dividends and capital gains distributions at the redemption or bid price (net asset value). In addition, no sales load is charged if shareholders wish to exchange their shares in one fund for shares in another fund managed by Investors Diversified Services, Inc. (see *infra*, p. 16). (App. 26.)

There are also no-load open-end investment companies. The no-load funds may charge up to a two percent premium over the net asset value at the time of issuance of a security or at the time of redemption. But a no-load fund may not charge selling commissions at the time of issuance. See Section 10(d), Investment Company Act of 1940, *supra* (15 U.S.C. 80a–10(d)). The two percent premium is not included in the daily asked and bid prices.

charge. Though shares in mutual funds are freely transferable, they are not sold in the securities market. Purchases of mutual fund shares, including shares in the three funds held by the decedent here, ordinarily take place between the investor and the issuing company or its distributor, and the only practical method of disposition is redemption. (Pet. 15–16, 24–26; Pltf. Exs. 3 (p. 14), 4 (p. 13), and 6 (p. 16).)

The three funds involved here were organized and are managed by Investors Diversified Services, Inc. ("IDS"), which is not an open-end investment company itself, but which acts as underwriter, distributor, and manager for the funds. (Pet. 13.) IDS received, in full payment for its services as distributor of shares of these funds, a distribution fee equal to the amount of the sales charge. The remainder of the amount paid by the purchaser of the shares (net asset value) was remitted to the investment company. (Pet. 26.)

On the decedent's federal estate tax return, the respondent-executor valued the shares of the three funds at their redemption price on the date of the decedent's death. In accordance with Section 20.2031-8(b) of the Treasury Regulations on Estate Tax, the Commissioner determined that these shares should be valued at their public offering price on the date of the decedent's death, and accordingly asserted an estate tax deficiency. After paying the tax, the respondent filed a suit for refund on the ground that Section 20.2031-8(b) is invalid. The district court agreed with the respondent and held the regulation invalid. (Pet. 13–14, 22.) The court of appeals affirmed. (Pet. 23–24.)

SUMMARY OF ARGUMENT

Section 2031 of the Internal Revenue Code of 1954, Appendix, *infra*, p. 23, provides that the value of a decedent's gross estate "shall be determined by including * * * the value at the time of * * * death of all property * * *." Section 20.2031–8(b) of the Treasury Regulations on Estate Tax, Appendix, *infra*, pp. 25–26, provides that for estate tax purposes, the "value" of a share in an open-end mutual fund is the public offering ("asked") price of the share. The sole question before the Court in this case is the validity of this regulation. If the regulation is reasonable and consistent with the statute, it must be sustained even though the Commissioner might have taken alternative approaches to valuing mutual fund shares. *United States* v. *Correll*, 389 U.S. 299, 306–307.

The general principle of valuation which the Commissioner applies for estate tax purposes is that the value of an item is its "fair market value," which is the "price at which the property would change hands between a willing buyer and a willing seller * * *." Section 20.2031–1(b) of the Treasury Regulations on Estate Tax (1954 Code), Appendix, *infra*, pp. 24–25. The regulation at issue here, which values mutual funds at the "asked" price, or the price which a member of the public must pay to acquire a share in the mutual fund market, is an application of this general principle of valuation. This Court has long accepted the Commissioner's concept of value in analogous situations. Thus, in *Guggenheim* v. *Rasquin*, 312 U.S. 254, the Court held that the replacement cost of single-premium life insurance

policies, rather than the substantially lower cash surrender value, determined the value of those policies.

In applying the willing buyer-willing seller rule it has long been the practice to include in the value of various items costs such as selling commissions which are included in the retail price quoted to the public. For example, the value of jewelry has been held to be its replacement cost, including the federal excise tax which the dealer passes on to the purchaser, even though these costs might not be recovered if the purchaser should sell the item. Similarly, the willing buyer-willing seller rule precludes the deduction of selling costs and commissions from the valuation of assets, such as real estate and stocks, whose sale is likely to necessitate the payment of commissions.

The Sixth and Seventh Circuits and the Tax Court have held the regulation at issue valid, while the court of appeals below and the Ninth Circuit have held the regulation invalid. The courts which have held the regulation invalid appear to have based their holding largely on the theory that it creates a hardship to value mutual fund shares at an amount in excess of what the estate could obtain if it chose to sell the shares. This argument ignores the fact that if the estate and the beneficiaries continue to hold the mutual fund shares, they enjoy valuable advantages not available if the shares are redeemed, such as the right to use capital gains and dividends to purchase additional shares at net asset value and the right to exchange the shares in one fund for shares in another fund without paying the load. It also ignores the tax consequences

which occur if the estate or the beneficiaries sell the shares. In the former case, the estate ordinarily receives an administrative expense deduction for the difference between the bid and asked prices. Section 20.2053-3(d)(2) of the Treasury Regulations on Estate Tax (1954 Code). In the latter case, the difference constitutes a loss for income tax purposes. Section 1.1014-1, Treasury Regulations on Income Tax (1954 Code).

The court below appears to have concluded that the Commissioner's method of valuing mutual fund shares is inconsistent with the method used for valuing certain other types of securities, including common stocks, government bonds, and restricted stock. (Pet. 30–32.) Analysis of the provisions governing the valuation of each of these securities, however, shows either that the valuation methods used in those situations reflect precisely the same willing buyer-willing seller concept used to value mutual funds, or that peculiar features of these securities require in some circumstances an adjustment of the usual formula.

ARGUMENT

SECTION 20.2031–8(B) OF THE TREASURY REGULATIONS ON ESTATE TAX (1954 CODE), WHICH REQUIRES SHARES OF MUTUAL FUNDS TO BE VALUED FOR ESTATE TAX PURPOSES AT THEIR PUBLIC OFFERING OR ASKED PRICE, IS A REASONABLE IMPLEMENTATION OF SECTION 2031 OF THE INTERNAL REVENUE CODE OF 1954

Section 2031 of the Internal Revenue Code of 1954, Appendix, *infra*, p. 23, provides that the value of a decedent's gross estate "shall be determined by in-

cluding to the extent provided for in this part, the value at the time of * * * death of all property * * *." Section 2033 of the Code, Appendix, *infra*, p. 23, provides for inclusion of "the value of all property to the extent of the interest therein of the decedent at the time of his death." Under his authority to "prescribe all needful rules and regulations for the enforcement of this title" (Section 7805(a) of the Internal Revenue Code of 1954 (26 U.S.C.)), the Commissioner in 1963 promulgated Section 20.2031-8(b) of the Treasury Regulations on Estate Tax (1954 Code), Appendix, *infra*, pp. 25–26, which provides that for estate tax purposes the value of a share in an open-end investment company (mutual fund) is the public offering (asked) price of a share.*

The sole question before this Court is the validity of this regulation. If the challenged regulation is reasonable and consistent with the statute, it must be sustained. *Commissioner* v. *South Texas Co.*, 333 U.S. 496, 501. It may be that the Commissioner could have taken a different approach to determining "value" of mutual fund shares within the meaning of Section 2031. The Regulations might, for example, have based value exclusively upon the amount which the estate would realize upon liquidation of the shares, or upon the mean between the bid and asked prices, rather

* A corresponding regulation was promulgated with respect to inter vivos gifts. See Section 25.2512-6(b) of the Treasury Regulations on Gift Tax (1954 Code), Appendix, *infra*, p. 27, which provides that for gift tax purposes the fair market value of a share in an open-end investment company is the public offering (asked) price.

than upon the amount which a member of the public must pay in order to purchase the shares. A Treasury Regulation is not invalid, however, merely because there is an alternative method of implementing the statute. As this Court stated in *United States* v. *Correll*, 389 U.S. 299, 306–307, and reiterated in *Bingler* v. *Johnson*, 394 U.S. 741, 750–751:

> Alternatives * * * are of course available. Improvements might be imagined. But we do not sit as a committee of revision to perfect the administration of the tax laws. Congress has delegated to the Commissioner, not to the courts, the task of prescribing "all needful rules and regulations for the enforcement" of the Internal Revenue Code. 26 U.S.C. § 7805(a). In this area of limitless factual variations, "it is the province of Congress and the Commissioner, not the courts, to make the appropriate adjustments." *Commissioner* v. *Stidger*, 386 U.S. 287, 296. The role of the judiciary in cases of this sort begins and ends with assuring that the Commissioner's regulations fall within his authority to implement the congressional mandate in some reasonable manner.

See also *Ruehlmann* v. *Commissioner*, 418 F. 2d 1302 (C.A. 6), affirming 50 T.C. 871, certiorari denied, 398 U.S. 950, rehearing denied, 400 U.S. 856; *DuPont's Estate* v. *Commissioner*, 233 F. 2d 210 (C.A. 3), certiorari denied, 352 U.S. 878; *Mearkle's Estate* v. *Commissioner*, 129 F. 2d 386 (C.A. 3).

We submit that Section 20.2031–8(b) of the Regulations reasonably implements the Congressional mandate that the "value" of a decedent's assets must be

included in the decedent's gross estate. Indeed, the judgment which this regulation embodies with respect to the appropriate method of valuing mutual fund shares is consistent with the concept of value that the Treasury generally applies in the estate tax context. This basic principle of valuation is set forth in Section 20.2031–1(b) of the Treasury Regulations on Estate Tax (1954 Code), Appendix, *infra*, pp. 24–25, which provides that the value of an item includible in a decedent's gross estate is the "fair market value" of that item on the date of the decedent's death or on the alternative date prescribed by Section 2032 of the Internal Revenue Code of 1954 (26 U.S.C.). Fair market value is defined as "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts."[1] As the regulation specifies, where an item is generally obtained by the public at retail, the fair market value is the retail price.

The underlying assumption of the "willing buyer-willing seller" rule is that the most realistic and appropriate value to place upon assets is the amount that the general public is willing to pay for them in the market where they are commonly sold. Since the shares of mutual funds are not sold in the securities

[1] The current version of Section 20.2031–1(b) was promulgated on June 14, 1965, by T.D. 6826, 1965–2 Cum. Bull. 367.

market and are obtainable only from the issuing company or its distributor, Section 20.2031–8(b) of the Regulations appropriately provides that mutual fund shares be valued at the "asked" price, *i.e.*, the price which a willing buyer would pay to acquire shares from the fund. Thus, Section 20.2031–8(b) is an application of the general principle set forth in Section 20.2031–1(b) and is analogous to the example stated in the regulation of the value of an automobile, which is the price at which the automobile could be purchased at retail by a member of the general public, not the lower price at which the automobile might be sold back to a dealer. See *Ruehlmann* v. *Commissioner*, *supra*, 418 F. 2d, p. 1304.[8]

[8] The shares at issue here are analogous in many respects to a new issuance of stock offered to the public through a broker-underwriter, where the issuing corporation receives the amount paid by the purchaser less the underwriting costs. The underwriting costs are generally reflected in the public offering price of original issues, even though the issuing corporation does not receive this portion of the price. If the shares of a new issue are required to be valued for tax purposes before a trading market for the securities has been established, see *infra*, pp. 14, 18–19, it could hardly be argued that underwriting fees which are included in the public offering price should be eliminated in determining the fair market value of the securities. (App. 67–69.) See Securities Act of 1933, c. 38, Title I, 48 Stat. 74, as amended, Sections 7, 10 and Schedule A(5) and (15)–(17) (15 U.S.C. 77g, 77j and 77aa(5) and (15)–(17)); Donaldson and Pfahl, *Corporate Finance* (2d ed., 1963), pp. 317–318; Dewing, *Financial Policy of Corporations* (5th ed., 1953), pp. 1100, 1128–1129; Husband and Dockery, *Modern Corporation Finance* (5th ed., 1962), pp. 342–343.

Although the regulation at issue here was promulgated on October 10, 1963,[1] this Court has long accepted the essential concept of value reflected in the regulation and has consistently applied it in analogous situations. In *Guggenheim* v. *Rasquin*, 312 U.S. 254, *Powers* v. *Commissioner*, 312 U.S. 259, and *United States* v. *Ryerson*, 312 U.S. 260, the Court held that the replacement cost of single-premium life insurance policies, rather than the substantially lower cash surrender value, determined the value of those policies for federal gift tax purposes. The Court rejected in these cases substantially the same argument advanced by the respondent here and accepted by the courts below, that the value of the property was necessarily what the donor could receive through redemption on

[1] T.D. 6680, 1963-2 Cum. Bull. 417. The district court below observed (Pet. 16, 21–22) that the Treasury did not issue this regulation until 1963, and that the various district directors did not follow a consistent position prior to the issuance of the regulation. These considerations present no adequate basis, however, for challenging the validity of the regulation, which was given prospective application only. In *Helvering* v. *Wilshire Oil Co.*, 308 U.S. 90, 103, this Court noted that the Commissioner's rule-making power is especially broad where the effect of the rule promulgated is prospective only. The fact that the Commissioner had previously entered into administrative settlements along the lines of the position asserted by the taxpayer in this case is irrelevant, for administrative settlements are not authoritative precedents (*Freeport Country Club* v. *United States*, 430 F. 2d 986, 993 (C.A. 7)) and are not binding on the Commissioner in other cases (*Lincoln Savings and Loan Assn.* v. *Commissioner*, 51 T.C. 82, 107–108, reversed by court of appeals, 422 F. 2d 90 (C.A. 9), but affirmed by this court, 403 U.S. 345). See also *Dixon* v. *United States*, 381 U.S. 68, 72–73.

the date of the gift. Though these cases involved gift tax, the Court has held that in the absence of express Congressional intent to the contrary, the gift and estate tax laws are to be construed *in pari materia*. *Merrill* v. *Fahs*, 324 U.S. 308, 311–313.

Indeed, it has long been the practice in applying the willing buyer-willing seller rule to include marketing costs, mark-ups, and selling commissions in the value of various items for gift and estate tax purposes, where these commissions and taxes are included in the price quoted to the public. Lowndes and Kramer, *Federal Estate and Gift Taxes* (2d ed.), pp. 441, 465–466. In *Estate of Gould* v. *Commissioner*, 14 T.C. 414, taxpayer purchased a ring at retail and gave it to his wife. The Tax Court, citing *Guggenheim* v. *Rasquin*, *supra*, held that the value of the ring for gift tax purposes was the replacement cost, including the federal excise tax which the dealer passed on to the purchaser. The court reasoned that the situation was the same as if the taxpayer had given his wife the money to purchase the ring and she had done so. The same result was reached in *Publicker* v. *Commissioner*, 206 F. 2d 250 (C.A. 3), certiorari denied, 346 U.S. 924; and *Duke* v. *Commissioner*, 200 F. 2d 82 (C.A. 2), certiorari denied, 345 U.S. 906, both of which also involved the valuation of jewelry.[10] By analogy, if the

[10] The court of appeals below undertook to distinguish the *Duke* case on the ground that in *Duke* there was no evidence of the fair market value of the property other than its retail value. (Pet. 31.) In this respect, the court appears to have

decedent here had bequeathed cash to be used for the purchase of mutual fund shares, she would have had to bequeath sufficient funds to pay for the "load". Similarly, the willing buyer-willing seller rule precludes the deduction of selling costs and commissions from the valuation of assets whose sale is likely to necessitate the payment of commissions, and hence the valuation is not the amount which the seller could realize on the sale of the property. If, for example, an estate includes Blackacre, which is valued at $100,000, the estate is charged with the full $100,000 value, not $94,000, even though it is highly likely that the estate or its beneficiaries will pay a $6,000 selling commission upon sale of the property. Lowndes and Kramer, *supra*, p. 441. As in our case, the value for estate tax purposes is the amount which a willing purchaser would pay for the asset, not the amount which the estate or its beneficiaries would realize upon sale. The commissions paid to brokers on sale of stocks are ordinarily treated in the same manner. Consequently, the estate is required to include the full value of shares even though if the stock is sold the seller will realize only the quoted market price of the shares minus the brokerage commission. Of course, if the estate sells the shares, it will ordinarily receive an administrative

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questioned the basic assumption embodied in Section 20.2031-1(b) that retail value is generally the appropriate measure of value for tax purposes. It is the price which a willing buyer is willing to pay to a willing seller for the purchased item.

expense deduction for the selling costs. See *infra*, pp. 17–18.

Though other valuation methods might have been reasonably chosen, we submit that the Treasury's decision to value mutual fund shares at the asked price, the price which a willing-buyer member of the general public pays for them, is reasonable and in accordance with the statute. The regulation was held valid by both the Tax Court and the Sixth Circuit in *Ruehlmann* v. *Commissioner*, *supra*. And the companion gift tax regulation (see footnote 6) was held valid by the Seventh Circuit in *Howell* v. *United States*, 414 F. 2d 45. On the other hand, the Second Circuit in the instant case, and the Ninth Circuit by a divided court in *Davis* v. *United States*, 460 F. 2d 769,[11] have held the regulation invalid.[12]

The courts below appear to have based their conclusion that this regulation is unreasonable largely on

[11] The Government did not seek certiorari in *Davis* because the amount involved in that case was small (approximately $800) and because the issue is adequately presented in the instant case.

[12] In addition to the cases cited above, the regulation was approved in *Estate of York* v. *Commissioner*, 28 T.C.M. 1271, and *Norton* v. *United States*, 70-1 U.S.T.C., par. 12,684 (W.D. Wash.). Neither of those cases was appealed. The regulation was disapproved in *Hicks* v. *United States*, 335 F. Supp. 474 (D. Colo.), where no appeal was taken by the United States because of the dismissal of the taxpayer's complaint on other grounds. *Hicks* is before the Tenth Circuit (No. 72-1360) on taxpayer's appeal. The issue is also pending before the Court of Claims in *Lyons* v. *United States*, No. 354-70.

the ground that it creates a hardship to value mutual fund shares at an amount in excess of what the estate could obtain if it chose to sell them. See, *e.g.*, Pet. 19, 33. Though this argument may appear at first glance to have some appeal, it ignores both the economic reality of mutual fund ownership and the tax consequences which occur upon sale of the shares. To begin with, if the estate and the beneficiaries continue to hold the mutual fund shares, they enjoy several valuable advantages not available if the shares are redeemed. These include the right to use capital gains and dividends to purchase additional shares at net asset value and (in the case of funds distributed by IDS), the right to exchange the shares in one fund for shares in another fund without paying the load. See *supra*, note 5. In this regard the shares are analogous to the insurance policies which the Court dealt with in the *Guggenheim* case, in which the Court noted that certain special features, such as the right to receive the face amount of the policy at death, gave those assets an inherent value greater than the cash surrender value. Although the courts below attempted to distinguish the instant case from *Guggenheim* on the basis of the special privileges attached to the insurance policies at issue in *Guggenheim*, the distinction, if any, is one of degree; though the bundle of rights constituting ownership of a life insurance policy does differ to some extent from the rights in a

mutual fund share, each offers advantages to the holder that are destroyed by redemption.[11]

Analysis of the tax consequences of selling or redeeming the shares at issue here also undercuts the notion that it is unreasonable to value these assets at an amount greater than the estate could realize upon redemption. If the executor of the estate redeemed the mutual fund shares, it would be rare that the net amount subject to tax would be more than the bid price, because Section 20.2053-3(d)(2) of the Treasury Regu-

[11] In any event, the reliance which the courts below placed on the alleged distinction between this case and *Guggenheim* shows that the courts below failed to recognize the basis of that decision. The Court in *Guggenheim* did not question the willing buyer-willing seller rule then set forth in Treasury Regulations 79, Art. 19(1), nor did it question the theory that replacement cost is ordinarily the appropriate value to place upon property for tax purposes. The Court referred to the added value inherent in the special features of the single-premium insurance policies not in order to restrict application of the Commissioner's approach to situations in which property has significant value beyond its cash redemption value, but, rather, in response to taxpayer's argument that "the market for insurance contracts is usually the issuing companies or the banks who will lend money on them" and that "banks will not loan more than the cash-surrender value." The Court enumerated the other features of the policy in order to illustrate that "[a]ll of the economic benefits of a policy must be taken into consideration in determining its value * * *" (312 U.S. at 256–257), concluding that "the value of these policies at the date of the gift was the amount which the insured had expended to acquire them. Cost is cogent evidence of value" (312 U.S. at 257–258).

lations on Estate Tax (1954 Code) (26 C.F.R.) allows a deduction as an administration expense for the difference between the redemption price and the public offering price if the shares are sold in order to pay the decedent's debts, expenses of administration, or taxes, to preserve the estate, or to effect distribution. If the shares are acquired by a beneficiary from the estate and sold by him at a price below the estate-tax valuation, the ensuing difference would constitute a loss for income tax purposes. Sections 1001 and 1002, Internal Revenue Code of 1954 (26 U.S.C.); Section 1.1014–1, Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.); *Levin* v. *United States*, 373 F. 2d 434 (C.A. 1). In view of these provisions, there is little basis for respondent's contention below that the regulation in question causes hardship to the owners of mutual funds.

In support of the result which it reached, the court below reasoned that the method of valuing mutual fund shares is inconsistent with the method used for valuing certain other types of securities. (Pet. 30–31.) For example, under Section 20.2031–2 of the Treasury Regulations on Estate Tax, listed stocks are valued at the mean between the highest and lowest quotations on the date of death less any adjustment for a large block of stock whose sale would affect the market price. But Section 20.2031–2 is entirely consistent with the regulation under attack here, because the quoted price of a listed stock, like the asked price of a mutual fund, is the amount which a willing buyer pays to a willing seller. Since the price of a listed

stock fluctuates in the course of a trading day on the stock exchange, it was necessary for the Regulations to designate which quotation on the statutory date of valuation would be used for tax purposes. The mean between the highest and lowest selling price on that date was considered a fair and convenient choice.[14]

The court of appeals also found (Pet. 32–33) an inconsistency between the valuation of mutual fund shares at the asked price and the treatment of certain government bonds, which are available for the payment of estate tax at par even if they are selling in the market at a lower price. Such bonds are valued at par for estate tax purposes. See *Candler* v. *United*

[14] Nor is the regulation at issue here inconsistent with the method of valuing shares in unlisted stocks which are traded over the counter. Section 20.2031-2(b) of the Regulations provides that if there is an ascertainable market for over-the-counter securities, they are valued in the same manner as listed shares, *i.e.*, at the mean between the highest and lowest quoted selling prices on the date of valuation. If there are no sales during a "reasonable" period before and after the valuation date, then Section 20.2031-2(c) of the Regulations provides that the value is "the mean between the bona fide bid and asked prices on the valuation date, or if none, * * * [the] weighted average of the means between the bona fide bid and asked prices on the nearest trading date before and the nearest trading date after the valuation date, if both such nearest dates are within a reasonable period." This provision takes account of the fact that, depending upon a number of complex factors, unlisted shares may be purchased for an amount somewhere between the highest bid and lowest asked price. See generally, Report of Special Study of Securities Market of the Securities and Exchange Commission, H. Doc. No. 95, 88th Cong., 1st Sess., 1963, Part 2, Chapter VII, pp. 541–678. For administrative convenience, the value of these shares is the mean price between the bid and asked prices on the applicable datea.

States, 303 F. 2d 439 (C.A. 5). The court appears to have assumed that the par value of the bond in this situation is analogous to the redemption price of a mutual fund. The analogy, however, is unsound. The Treasury allows certain bonds to be applied at par against the estate tax in order to make government bonds a more attractive and secure investment for estate planning purposes. The executor of an estate which holds bonds selling at a price below par will obviously use those bonds to discharge the estate tax obligation. For this purpose, in these circumstances, the bonds are worth par, and an anomalous result would occur if the estate were able to apply the bonds at par to discharge its estate tax obligation while valuing them at the lower market price for purposes of calculating the estate tax. The requirement that bonds be valued at par in these circumstances is simply a reflection of the special value which the bonds have when used to pay estate tax at par.

Nor is the regulation under consideration here inconsistent with Treasury Regulations Section 20.2031-2(h), which provides that the traditional concepts of fair market value may be inoperative with respect to the valuation of stock subject to restrictive agreements. (Pet. 32-33.) See *United States* v. *Land*, 303 F. 2d 170 (C.A. 5), certiorari denied, 371 U.S. 862. Restricted shares, ordinarily held by corporate employees, frequently have a value in the hands of the restricted stockholder which is considerably lower than the price at which unrestricted shares could be bought or sold on the open market. If restricted shares were valued without regard to the restrictions, and in the same manner as

unrestricted shares, the valuation would be contrary to fact, and the tax consequences would work considerable hardship in many instances; indeed, this approach would operate to value shares at an amount not only greater than the restricted shareholder could receive on sale of the shares, but also greater than the amount that a willing buyer would pay for shares subject to the relevant restrictions.

Finally, we note that the mutual fund shares under consideration here are valued for income tax purposes in the same manner that they are valued for estate and gift tax purposes. Consequently, persons who have acquired these shares by devise, and in certain circumstances by gift (see Section 1015 of the 1954 Code), enjoy the benefits of the higher basis afforded by the Commissioner's decision to calculate fair market value in terms of the asked price, the price that must be paid to purchase the shares. Similarly, if mutual fund shares are donated to an exempt charitable organization, the amount of the donor's deduction is calculated with reference to the fair market value, or asked price, of the shares. See Section 1.170-1(c) of the Treasury Regulations on Income Tax (1954 Code). Had the Commissioner chosen the valuation method proposed by respondent and the courts below, income taxpayers would doubtless have claimed that it was unreasonable to value their shares for purposes of computing basis or ascertaining the amount of a charitable deduction at an amount less than it would have cost to purchase the shares on the relevant valuation date. The answer to that argument is the same as our answer here. The Commissioner has

chosen one of at least two reasonable methods of valuing mutual fund shares. In our view he has chosen wisely. But even if "improvements might be imagined," the regulation at issue falls within the Commissioner's "authority to implement the congressional mandate in some reasonable manner." *United States v. Correll, supra.*[15]

CONCLUSION

For the reasons stated, the judgment of the court of appeals should be reversed.

Respectfully submitted.

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NOVEMBER 1972.

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[15] Several unsuccessful attempts have been made to amend Section 2031 of the Code to provide for valuation of shares in a mutual fund at the redemption price. The following bills have been introduced in the House of Representatives and referred to the Committee on Ways and Means: H.R. 662, 90th Cong., 1st Sess., dated January 10, 1967; H.R. 4458, 90th Cong., 1st Sess., dated February 1, 1967; H.R. 14,770, 90th Cong., 2d Sess., dated January 23, 1968; H.R. 844, 91st Cong., 1st Sess., dated January 3, 1969; H.R. 866, 91st Cong., 1st Sess., dated January 3, 1969; H.R. 2322, 92d Cong., 1st Sess., dated January 26, 1971; H.R. 9370, 92d Cong., 1st Sess., dated January 26, 1971. None of these bills has yet been reported out of committee. Although the inaction of Congress is not the equivalent of legislation, it is some evidence that Congress does not feel it necessary to legislate to overturn the regulation.

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 2031 [as amended by Sec. 18(a), Revenue Act of 1962, P.L. 87-834, 76 Stat. 960]. DEFINITION OF GROSS ESTATE.

(a) *General.*—The value of the gross estate of the decedent shall be determined by including to the extent provided for in this part, the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated.

(b) *Valuation of Unlisted Stock and Securities.*—In the case of stock and securities of a corporation the value of which, by reason of their not being listed on an exchange and by reason of the absence of sales thereof, cannot be determined with reference to bid and asked prices or with reference to sales prices, the value thereof shall be determined by taking into consideration, in addition to all other factors, the value of stock or securities of corporations engaged in the same or a similar line of business which are listed on the exchange.

SEC. 2033 [as amended by Sec. 18(a), Revenue Act of 1962, *supra*]. PROPERTY IN WHICH THE DECEDENT HAD AN INTEREST.

The value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death.

Treasury Regulations on Estate Tax (1954 Code) (26 C.F.R.):

§ 20.2031-1 *Definition of gross estate; valuation of property.*

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(b) *Valuation of property in general.* The value of every item of property includible in a decedent's gross estate under sections 2031 through 2044 is its fair market value at the time of the decedent's death, except that if the executor elects the alternate valuation method under section 2032, it is the fair market value thereof at the date, and with the adjustments, prescribed in that section. The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. The fair market value of a particular item of property includible in the decedent's gross estate is not to be determined by a forced sale price. Nor is the fair market value of an item of property to be determined by the sale price of the item in a market other than that in which such item is most commonly sold to the public, taking into account the location of the item wherever appropriate. Thus, in the case of an item of property includible in the decedent's gross estate, which is generally obtained by the public in the retail market, the fair market value of such an item of property is the price at which the item or a comparable item would be sold at retail. For example, the fair market value of an automobile (an article generally obtained by the public in the retail market) includible in the decedent's gross estate is the price for which an automobile of the same or approximately the same description, make, model, age, condition, etc., could be purchased by a member of the general public and not the price for which the particular automobile of the

decedent would be purchased by a dealer in used automobiles. Examples of items of property which are generally sold to the public at retail may be found in §§ 20.2031–6 and 20.2031–8. The value is generally to be determined by ascertaining as a basis the fair market value as of the applicable valuation date of each unit of property. For example, in the case of shares of stock or bonds, such unit of property is generally a share of stock or a bond. Livestock, farm machinery, harvested and growing crops must generally be itemized and the value of each item separately returned. Property shall not be returned at the value at which it is assessed for local tax purposes unless that value represents the fair market value as of the applicable valuation date. All relevant facts and elements of value as of the applicable valuation date shall be considered in every case. The value of items of property which were held by the decedent for sale in the course of a business generally should be reflected in the value of the business. For valuation of interests in businesses, see § 20.2031–3. See § 20.2031–2 and §§ 20.2031–4 through 20.2031–8 for further information concerning the valuation of other particular kinds of property. For certain circumstances under which the sale of an item of property at a price below its fair market value may result in a deduction for the estate, see paragraph (d)(2) of § 20.2053–3.

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§ 20.2031–8. *Valuation of certain life insurance and annuity contracts; valuation of shares in an open-end investment company.*

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(b) *Valuation of shares in an open-end investment company.* (1) The fair market value of a share in an open-end investment company (commonly known as a "mutual fund") is the

public offering price of a share, adjusted for any reduction in price available to the public in acquiring the number of shares being valued. In the absence of an affirmative showing of the public offering price in effect at the time of death, the last public offering price quoted by the company for the date of death shall be presumed to be the applicable public offering price. If the alternate valuation under section 2032 is elected, the last public offering price quoted by the company for the alternate valuation date shall be the applicable public offering price. If there is no public offering price quoted by the company for the applicable valuation date (e.g., the valuation date is a Saturday, Sunday, or holiday), the fair market value of the mutual fund share is the last public offering price quoted by the company for the first day preceding the applicable valuation date for which there is a quotation, adjusted for any reduction in price available to the public in acquiring the number of shares being valued. In any case where a dividend is declared on a share in an open-end investment company before the decedent's death but payable to shareholders of record on a date after his death and the share is selling "ex-dividend" on the date of the decedent's death, the amount of the dividend is added to the ex-dividend quotation in determining the fair market value of the share as of the date of the decedent's death. As used in this paragraph, the term "open-end investment company" includes only a company which on the applicable valuation date was engaged in offering its shares to the public in the capacity of an open-end investment company.

(2) The provisions of this paragraph shall apply with respect to estates of decedents dying after October 10, 1963.

Treasury Regulations on Gift Tax (1954 Code) (26 C.F.R.):

§ 25.2512–6. *Valuation of certain life insurance and annuity contracts; valuation of shares in an open-end investment company.*

* * * * *

(b) *Valuation of shares in an open-end investment company.* (1) The fair market value of a share in an open-end investment company (commonly known as a "mutual fund") is the public offering price of a share, adjusted for any reduction in price available to the public in acquiring the number of shares included in the particular gift. In the absence of an affirmative showing of the public offering price in effect at the time of the gift, the last public offering price quoted by the company for the date of the gift shall be presumed to be the applicable public offering price. If there is no public offering price quoted by the company for the date of the gift (e.g., the date of the gift is a Saturday, Sunday or holiday), the fair market value of the mutual fund share is the last public offering price quoted by the company for the first day preceding the date of the gift for which there is a quotation, adjusted for any reduction in price available to the public in acquiring the number of shares included in the particular gift. As used in this paragraph, the term "open-end investment company" includes only a company which on the date of the gift was engaged in offering its shares to the public in the capacity of an open-end investment company.

(2) The provisions of this paragraph shall apply with respect to gifts made after October 10, 1963.

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